[Case Title] In re: C. J. Rogers, Inc., Debtor
[Case Number] 91-20388
[Bankruptcy Judge] Arthur J. Spector
[Adversary Number]XXXXXXXXXX
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UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION - FLINT

In re: C. J. ROGERS, INC., Case No. 91-20388
Chapter 11

Debtor.
_____/

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**MEMORANDUM OPINION**
**ON AETNA'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

Aetna filed a motion for relief from the stay so that it may pursue state law remedies as a creditor secured in assets of the Debtor. The Debtor objected to Aetna's claim against the estate. Each is a contested matter. See 9 Collier on Bankruptcy, ¶9014.03 (15th ed. 1991). This Court has jurisdiction over these disputes, which are core proceedings.

28 U.S.C. §1334; 28 U.S.C. §157(b)(2)(B), (G).

During the 1970's, Aetna bonded various construction projects of Charles J. Rogers Construction Company and Charles J. Rogers, Inc. (hereinafter collectively referred to as OC for "Old Companies"). OC encountered financial difficulty, which put Aetna at risk of having to pay millions of dollars on these bonds. In order to stave off these potentially tremendous bond defaults, Aetna apparently determined that it was in its own interest to see to it that OC remain in business to complete the bonded projects. It therefore undertook to advance money to OC to allow OC to finish both bonded and non-bonded jobs. M2 ¶3; JPS5 ¶¶1, 2.[1] Eventually, OC's insolvency resulted in its state court composition proceedings, which commenced in July, 1979. As a result of that reorganization, some of OC's assets were sold to the newly incorporated Debtor in return for the Debtor's secured notes[2] and other consideration. JPS6 ¶¶5, 6. On November 11, 1981, Aetna, OC and the Debtor signed an agreement whose effectiveness ran from May 1, 1980, pursuant to which OC assigned the note and accompanying

[1]"M2 ¶3" means Motion by Aetna for Partial Summary Judgment, page 2, numbered paragraph 3. "A1-2 ¶2", for example, means Answer by the Debtor to Aetna's Motion, pages 1 through 2, numbered paragraph 2. "JPS6 ¶¶5-8" means Joint Final Pre-Trial Statement, Stipulated Facts, page 6, numbered paragraphs 5 through 8. Lettered exhibits are those submitted with Aetna's Motion for Partial Summary Judgment, while numbered exhibits are those submitted by the Debtor in its response to this motion.

[2]As OC was made up of two companies, there were multiple notes and other documents prepared, all dated May 1, 1980. Exhibit E; Exhibit F. For purposes of this motion, however, there is no need to distinguish among them. Therefore, the notes will hereafter be referred to in the singular.

security documents to Aetna. Exhibit D; JPS7 ¶7, 8. Aetna thereby became a creditor of the Debtor to the extent of the note balance.

The principal amount of the note made by the Debtor and now held by Aetna is $4,359,680. The issue in these contested matters is whether the Debtor paid any part of that amount through offsets. Aetna filed a motion for partial summary judgment pursuant to F.R.Bankr.P. 56, which incorporates F.R.Civ.P. 56. Aetna alleged in the motion that there is no genuine issue of material fact with respect to some of the payments/setoffs at issue, and that it is entitled to a judgment on a portion of the note balance as a matter of law.[3]

Both payment and setoff are affirmative defenses, F.R.Civ.P. 8(c), incorporated by F.R.Bankr.P. 7008, and the Debtor has the burden of proof on these issues. First Nat'l Bank v. Hurricane Elkhorn Coal Co., 763 F.2d 188, 190 (6th Cir. 1985); Desjardins v. Desjardins, 308 F.2d 111, 116 (6th Cir. 1962). Aetna advanced two principal arguments why the Debtor cannot establish its affirmative defenses with respect to the specific items in question. First it argued that, even if the Debtor is able to prove that it made payments to, or on behalf of, OC (the original drawer of the note), Aetna need not credit those payments to the note balance because Aetna is a holder in due course.

Second, Aetna argued that it cannot be held responsible for

[3]As to the balance of the alleged payments/offsets, Aetna does not press for judgment at this time, but will defer its arguments on these items to the time of trial.

payments the Debtor may have made to creditors of OC or for expenses the Debtor incurred in completing OC's jobs because the Debtor can produce no writing signed by Aetna in which Aetna agreed to be responsible. In this argument, Aetna relies upon the statute of frauds, Mich. Comp. Laws §566.132(b). For the reasons which follow, I believe that Aetna is only partially correct, and so its motion will be granted in part and denied in part.

The specific payments or alleged offsets which are challenged by Aetna's motion involve: a) costs and expenses allegedly incurred by the Debtor in completing construction projects which OC was obligated to perform; b) fees paid to OC's lawyer for his state court reorganization work; and c) refunds for alleged overcharges relating to assets sold by OC to the Debtor.[4] For ease of discussion, these charges will sometimes be collectively called "offsets."

Aetna argued that it is a holder in due course of the note and therefore no payments the Debtor may have made to or on behalf of OC after Aetna obtained the note--effectively, on May 1, 1980--can be used to diminish the debt owed to Aetna. The rationale for this conclusion is that payment is a personal defense, not a "real" defense, and a holder in due course takes free of all but the real defenses specified in Mich. Comp. Laws

[4]Another category of offsets, involving alleged payments by the Debtor to the Internal Revenue Service, will be discussed separately. See infra pp. 9-11.

§440.3305.[5] See 1 James J. White and Robert S. Summers, Uniform Commercial Code §14-9 (3d ed. 1991); Bank of Miami v. Florida City Express, 367 So.2d 683, 684 (Fla. Dist. Ct. App. 1979) ("[T]he long familiar, universal rule, as now expressed in [UCC §3-305], [is] that a holder in due course takes and holds a negotiable instrument free of all defenses of which he is not on notice. And it is very clear that this rule includes the defense of discharge or payment."). Aetna might have a good argument if it were in fact a holder in due course of the note.[6] But as the Debtor pointed out, that is not the case.

A "holder in due course" is defined in UCC §3-302(1) as one who takes an "instrument," and who satisfies various other criteria. "Instrument," in turn, is defined in UCC §3-102(1)(e) as a "negotiable instrument." To be a "negotiable instrument," a writing must include, inter alia, "an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this article." UCC §3-104(1)(b) (emphasis added).

The note at issue here contains the following language:

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[5]For convenience, subsequent references to the Uniform Commercial Code will be in the generic citation form. Mich. Comp. Laws §440.3305, for example, will hereafter be cited as UCC §3-305.

[6]It bears noting, however, that the protection afforded to a holder in due course against personal defenses only relates to parties "with whom the holder has not dealt." UCC §3-305(2). And since Aetna took the note pursuant to an agreement to which both Aetna and the Debtor were parties, §3-305(2) would arguably be of no avail to Aetna even if it were a holder in due course.

> . . . the payment of this promissory note shall be conditional upon the prior payment in full of all liens held by the U.S. Internal Revenue Service and the State of Michigan on the assets so purchased, and in the event the liens are not paid prior to the required payment of this note, the amount of the liens shall first be paid and the amount of the payment due on the promissory note shall be reduced by that amount.

Exhibits E, F. The promise to pay the sum stated in the note is thus made conditional upon the maker not having paid money to the IRS or the State of Michigan to clear liens on assets which were transferred by OC to the Debtor. This condition is expressed in the writing itself, rather than "implied" or "constructive." See UCC §3-105(1)(a). Accordingly, the note is not a "negotiable instrument," and therefore Aetna cannot hold it as a "holder in due course."[7]

Aetna's second argument with respect to these offsets has greater merit. It claimed that bills submitted by the Debtor to OC for work the Debtor performed after May 1, 1980 (or for legal bills or for asset overcharges) cannot be credited to the note Aetna holds because the effect of doing so would make Aetna the party who actually pays the bills (or refunds the overcharges).

It is obvious that OC is principally liable for these charges.

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[7]The Debtor also argued that Aetna did not take the note in "good faith" because it failed to make appropriate inquiries about potential defenses that the Debtor had against OC. If the Debtor had presented any affidavits, deposition transcripts or other evidence to support this allegation, a triable issue might have been presented, thus precluding summary judgment. But the Debtor did not present any such evidence, and since I agree that Aetna is not a holder in due course for other reasons, I will not address this issue further.

Thus Aetna's liability, if any, would be in the nature of an obligation to answer for the debts of another. Aetna claimed that for such liability to attach, a writing is required by Mich. Comp. Laws §566.132(b), which provides in pertinent part that "[a] special promise to answer for the debt, default, or misdoings of another person" is void unless "in writing and signed by the party to be charged therewith." Because no such writing exists, Aetna argued, it cannot be held liable for the offsets challenged by its motion.

The Debtor disingenuously responded that it does not claim that Aetna promised or agreed to be responsible for OC's obligations; it merely claims that Aetna agreed to reduce the balance due on the note to the extent of such offsets. But payment by means of offset of a debt due to Aetna is the practical and legal equivalent of Aetna's direct payment of these expenses and backcharges. See Liberty Life Ins. Co. v. United States, 594 F.2d 21, 26 (4th Cir.), cert. denied, 444 U.S. 838 (1979) (Affirming the trial court's allowance of an interest deduction from taxable income, wherein the lower court reasoned that "credit for practical purposes is the equivalent of payment."); Commissioner v. Stearns, 65 F.2d 371, 373 (2d Cir.), cert. denied, 290 U.S. 670 (1933) ("'[C]redit' for practical purposes is the equivalent of 'payment.'"). The distinction between offsets and direct payments is therefore irrelevant for purposes of §566.132(b), and in order to defeat Aetna's motion for partial summary judgment the Debtor must refute the contention that Aetna never agreed in writing to be liable for

the charges upon which the claimed offsets are based.

The Debtor failed to do so. Instead of producing a writing signed by Aetna in which Aetna promises to be liable for OC's contract defaults, etc., the Debtor argued in its answer that Aetna's duty to allow these offsets "was acknowledged, recognized and not objected to by Aetna." Debtor's Brief p. 6. Of course, the Debtor must bring forth evidence tending to prove that Aetna assumed such a "duty." See Celotex Corp. v. Catrett, 477 U.S. 317, 324 (1986). But the Debtor produced no evidence--not even oral testimony by way of affidavit, deposition transcript, etc.--on this point. Most importantly, the Debtor produced no writing to satisfy the statute of frauds.[8]

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[8]In its answer to Aetna's motion, the Debtor implied that at some unspecified time an agreement was executed between it and OC by which (it seems) the Debtor assumed the obligation of completing OC's construction projects. However, no such agreement is appended to the answer, nor do details of this alleged agreement appear in the answer, the supporting brief or, more importantly, by way of affidavit. I will therefore disregard this (implicit) allegation.

Given my general understanding of the context of this case, it would not be surprising to learn that the completion by the Debtor of some or all of the construction projects at issue here spared Aetna from secondary liability arising from its bonding agreements. However, the Debtor did not argue that the original bond, if any, on these projects is a writing which fixes Aetna's liability for any of the disputed offsets. More importantly, even had it so argued, the Debtor did not produce the bonds. Moreover, if the Debtor merely substituted in for OC on these projects, it may have become the principal in the suretyship relationship with Aetna, and therefore had a contractual and common law obligation to indemnify and reimburse Aetna even if Aetna wound up paying the costs of completion. See generally In re V. Pangori & Sons, 53 B.R. 711 (Bankr. E.D. Mich. 1985). Thus the Debtor did not establish that it is entitled to charge Aetna for these offsets by virtue of the latter's contractual obligations as surety for some of OC's construction projects.

In a lame attempt to circumvent the requirement of a writing signed by Aetna, the Debtor argued that it "would rely on an estoppel theory" to bar Aetna from asserting the statute of frauds. Debtor's brief, p. 6. But the Debtor uses the wrong tense. If it wished to try this issue, the Debtor was required to establish now, not at trial or some other future date, that it has evidence which would raise a genuine issue of estoppel. See Columbus Trade Exchange v. Amca Int'l. Corp., 763 F. Supp. 946, 955 (S.D. Ohio 1991). However correct the Debtor may be in asserting that the mere allegation of estoppel to raise the statute of frauds creates a question of fact sufficient to preclude summary judgment under Michigan law,[9] that is not true under Rule 56 of the Federal Rules of Civil Procedure. Id.

I therefore conclude that Aetna is entitled to partial summary judgment to the extent that the Debtor is precluded from arguing that

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[9]The Debtor cited Conel Development, Inc. v. River Rouge Savings Bank, 84 Mich. App. 415, 423, 269 N.W.2d 621 (1978) for this proposition. But the statement by the court to that effect was dictum, as it was made in connection with the review of a general jury verdict in favor of the plaintiff. And other cases make clear that the rules in Michigan on summary judgment (now termed summary disposition) are similar to F.R.Civ.P. 56, to-wit: to avoid summary judgment, a party must do more than allege estoppel, it must bring forth some evidence to raise a question of fact on that issue. See Opdyke Investment Co. v. Norris Grain Co., 413 Mich. 354, 370, 320 N.W.2d 836 (1982) ("The plaintiff's alternate theory of promissory estoppel is sufficiently pleaded and supported to survive the defendants' motion for accelerated judgment based on the statute of frauds." (emphasis added)); see generally 7 Callaghan's Michigan Pl. & Prac., §43.09 (2d ed. 1991); Grossheim v. Associated Truck Lines, Inc., 181 Mich. App. 712, 715, 450 N.W.2d 40 (1989) ("Where the party opposing the motion fails to produce any evidence, the motion for summary disposition is properly granted.").

offsets it incurred subsequent to May 1, 1980 against OC may be credited against the note held by Aetna.

Aetna's motion also contested the Debtor's claim to an offset for payments allegedly made by the Debtor to the Internal Revenue Service to clear liens on the assets which OC transferred to the Debtor effective May 1, 1980. For purposes of this motion, Aetna conceded that those payments amounted to $926,970. M8 ¶22.

Aetna's argument that its holder-in-due-course status precludes the Debtor from obtaining credit for these payments fails for the same reason as Aetna's argument with respect to the other offsets: Aetna is not a holder in due course.

The very language in the note which precludes Aetna from holder-in-due-course status defeats its statute-of-frauds argument as well. The November 11, 1981 agreement (Exhibit D), which was signed by Aetna, refers to the note. The note, as we have seen, bears a specific provision that the Debtor's payments to clear tax liens on the assets it received from OC could be credited against the note. For purposes of considering Aetna's motion for summary judgment, those writings---Exhibit D and the note---constitute sufficient memoranda to satisfy the statute of frauds.

But Aetna went beyond the statute-of-frauds argument as to the IRS payments. It alleged that OC merely handed its own money over to the Debtor to enable the Debtor to write the checks to the IRS; therefore, no real payments were made by the Debtor--the payments actually came from OC.

M5 ¶13. However, the Debtor did not stipulate to this alleged fact, nor did Aetna support its allegation with evidence.

The Debtor claimed that on May 1, 1980, in conjunction with the sale of assets from OC to the Debtor, OC assigned to it OC's right to receive money from a joint venture agreement. A8 ¶10.[10] As part of the November 11, 1981 agreement between Aetna, OC and the Debtor, the parties included a list of accounts receivable held by OC which were sold to the Debtor. In oral argument, the Debtor claimed that OC's rights in the joint venture agreement was among these accounts receivable. However, the express language in the November 11, 1981 agreement (which, after all, the Debtor as well as OC executed) stated that "the old Rogers' companies [i.e., OC] . . . hereby agree to continue the payment schedule currently in effect with the Internal Revenue Service,[11] and further, agree that when the old Rogers' companies' obligation to the Internal Revenue Service is satisfied, that the old Rogers' companies will continue the same payment schedule with Aetna as the recipient of the funds."

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[10]In making this allegation, the Debtor actually referred to OC's rights in a tunnel construction project for the City of Detroit. Id. However, by the Debtor's own evidence, it is clear that OC had no contract with the City of Detroit to build the tunnel, but rather a contract which ran in favor of a joint venture of which OC was only a small part. Exhibit 2, Exhibit H. Nonetheless, I will assume that what the Debtor meant to say was that OC's interest in the joint venture (as opposed to the tunnel contract itself) formed a part of the consideration underlying the note it gave to OC.

[11]Exhibit J is the formal Internal Revenue Service Installment Agreement, in which the proceeds due to OC from the joint venture agreement were earmarked for the IRS.

Since this provision specifically obligated OC and not the Debtor to make these payments, it is dubious that the Debtor had the right to pay the IRS with the proceeds derived from the joint venture agreement. But Aetna's motion is bereft of any evidence to belie the Debtor's assertion.

Moreover, Aetna did not specifically allege that the $926,970 came solely from the joint venture agreement proceeds, which were concededly assigned first to the IRS and then to Aetna via the November 11, 1981 agreement.[12] Since no evidence was submitted on this point and no admission exists in the files, it may be that some or all of the funds were obtained from sources other than the joint venture agreement.

For the foregoing reasons, Aetna's motion for partial summary judgment with respect to the $926,970 in payments to the IRS will be denied. Consequently, the Court will enter partial summary judgment on the claim of Aetna as follows: $4,359,680 less $1,380,199 of alleged offsets and payments not affected by Aetna's motion, less $926,970 for a net allowed claim of $2,052,511.

Dated: January 9, 1992.

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ARTHUR J. SPECTOR
U.S. Bankruptcy Judge

[12]Aetna claimed that its right to these proceeds derives originally from OC's December 1, 1978 assignment of its accounts to Aetna (Exhibit C). Aetna's Brief, p. 10.